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C O N F I D E N T I A L SECTION 01 OF 04 BAGHDAD 001244

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TAGS: [EAGR](#) [ECON](#) [ETRD](#) [KCOR](#) [KDEM](#) [KPRV](#) [PGOV](#) [IZ](#)
SUBJECT: BEGINNING MUCH-NEEDED FOOD SUBSIDY REFORM

REF: A. BAGHDAD 375

[B](#). BAGHDAD 241

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[C](#). 2005 BAGHDAD 5079

[D](#). 2005 BAGHDAD 4559

[E](#). 2005 BAGHDAD 4108

Classified By: Economic Section Minister Counselor Thomas Delare, reasons 1.4 b/d

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U.S. military field reports confirm that most Iraqis do not receive their entire allotted ration basket each month. This

is particularly damaging in the poorest areas of Iraq -- located mainly in the far western regions of Anbar and Ninewa provinces and pockets of southeast Iraq -- where according to the 2003 UN WFP Baseline Food Security Analysis (the most recent available), about a third of the population is highly dependent on the PDS for survival.

[16](#). (C) The PDS is reportedly rife with corruption at every stage of its operation, from procurement contracting to final distribution of items to the Iraqi public. DG Kareem has stated that PDS-laden trucks sometimes disappear enroute to food distribution points, and that MoT officials sometimes sell PDS food articles to enrich themselves. A previous Iraq Reconstruction Management Office (IRMO) Trade Senior Consultant strongly suspected that foreign wheat shipments were being resold to fund terrorist operations and indicated that the MoT Inspector General office was likely involved in corrupt activities. Recent Iraqi press reports credit MoT with being the most corrupt ministry in the GOI.

[17](#). (C) The PDS hinders agricultural and private-sector development by sapping entrepreneurial initiative and encouraging dependence on the government. Deputy Prime Minister Chalabi has told us that he instructed MoT to offer higher prices to Iraqi producers for wheat and rice (ref B). (Note: We do not have evidence beyond verbal assurances from MoT officials that they actually pay higher prices to Iraqi producers. End note.) However, using Ministry of Agriculture production estimates and MoT procurement records,

we estimate that less than half of Iraqi wheat production is considered fit for PDS procurement, and the farmers are currently only capable of producing about 12% of annual PDS wheat needs. In addition, as ration recipients and corrupt MoT officials reportedly sell PDS items into the marketplace, they deflate and distort true market prices, making it difficult for Iraqi farmers to recover production costs on wheat and rice that they do not sell to MoT. In effect, MoT has set itself up as the dominant buyer of high-grade wheat and rice in Iraq, providing no incentive to private-sector buyers to enter the market, and decreasing the need for GOI investment in distribution infrastructure that would benefit small farmers and private distributors.

Cutting "Nonessential" Items

¶8. (C) According to DG Kareem, the most important items of the PDS are flour, rice, sugar, and cooking oil, mainly because Iraqis most need these items for daily living and because Iraqi farmers are currently incapable of producing sufficient quantities. "Nonessential" PDS items, according to Kareem, make up 25% of PDS expenditures and include adult milk, infant milk, baby food, beans, salt, tea, soap, and detergent. According to Kareem and local sources, Iraqis generally view these "nonessential" items as inferior in quality and prefer to buy higher-quality replacements in local retail markets. These same sources indicate that the Iraqi recipients sometimes sell the "nonessential" items for income, though the income they receive is significantly lower than what the GOI paid to provide the item initially. Kareem has told us that MoT plans to discontinue providing "nonessential" PDS items in 2006. (Note: Though press reports state that the MoT has done this, MoT sources indicate it has not happened.)

Providing Freedom of Choice

¶9. (C) Deputy Prime Minister (DPM) Chalabi recently told us that the GOI plans to monetize the PDS, giving Iraqis the opportunity to procure what they believe they need and spurring private-sector development in areas that the market (and not the government) dictates. Minister of Planning Barhim Salih has echoed this position to Embassy officials. According to recent Baghdad market prices, the annual cost to the GOI to provide every Iraqi with the monetary equivalent of a PDS basket would be approximately \$2.7 billion. Embassy supports the monetization decision and believes that the GOI should monetize gradually, starting in a province where private food distribution and marketing channels are already fairly strong, and then expanding to other provinces over time. As the monetization program spreads, the GOI will likely need to continue providing flour, rice, sugar, and cooking oil to the provinces where monetization has not yet been implemented.

¶10. (C) The GOI recently completed a "catch-up" voucher program, through which they compensated all Iraqi households

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for food shortages from January thru August 2005. The GOI distributed approximately \$450 million through over four

million vouchers, which Iraqis cashed at the nearest branch of the Rafidan or Rashid state-owned bank. According to Embassy, DFID, and GOI officials, initial indications are that the program has been successful, despite glitches in a few cities. DPM Chalabi said the program demonstrates the GOI's ability to successfully monetize the PDS.

¶11. (C) According to USAID's Agriculture Reconstruction and Development Program in Iraq (ARDI), most of Iraq's retail markets would likely be capable of providing sufficient

quantities of most PDS items in the absence of a government-operated PDS. The main exception would possibly be flour. Embassy Econ has collected market surveys that monitor price and availability of PDS items across Iraq, and though the recent fuel-price increases have caused food prices to go up in some areas, most PDS items have been readily available during "spot" surveys. (Note: It is uncertain how much of the local markets' food comes from PDS items sold into the market by undesiring recipients or corrupt MoT officials. End note.)

¶12. (C) As the GOI gradually discontinues procuring immense amounts of food, initially there may be supply shortages and price spikes in certain areas as private markets become fully functional. DPM Chalabi has said that the GOI plans to maintain reserves of flour and rice to sell on the open market at predetermined price marks (above market prices) to help hedge against food-price inflation. Embassy supports this action and believes that the GOI should also maintain reserves of cooking oil and sugar because there is no domestic production of these key PDS items. The GOI could also distribute the reserves to impoverished areas if food shortages occur.

Encouraging Private-Sector Growth

¶13. (C) DPM Chalabi told us that he has instructed MoT to procure domestically as much of its flour and rice reserves as possible, exhausting all Iraqi procurement options before turning to foreign suppliers. Iraq's population is projected to grow to 43 million by 2030, and it will need to import food supplies for the foreseeable future; however, this policy of maximizing domestic procurement will encourage Iraqi farmers to produce more wheat and rice, traditionally strong agricultural products for Iraq. It will also indirectly encourage private-sector development in Iraq's food distribution and marketing channels.

¶14. (U) Embassy PDS Reform Team will encourage the GOI to institute additional policies and programs to encourage private-sector development in Iraq's food distribution and marketing channels. One way would be for the GOI to sell its imported wheat to Iraq's 120 privately-owned flour mills, and for millers to in turn make a market in the flour they produce through developing private-sector distribution channels. Currently, MoT provides wheat and pays the mills to produce flour, which MoT then distributes through the PDS. Another way for the GOI to encourage private-sector growth would be to target loan programs to entrepreneurs who want to establish small- to medium-sized food-processing or distribution companies. The GOI could also use the savings from the declining PDS budget to improve infrastructure and support programs that would contribute to improved private-sector activity.

Eliminating the PDS

¶15. (C) The GOI has said it intends to eliminate the PDS over a four-year period, gradually drawing down the budget as food production, processing, and distribution strengthen, and freeing up resources for increased public investment. Several GOI officials, including Finance Minister Allawi, have said the PDS budget should be cut by 25% per year for four years and then eliminated. The 25% budget reduction from 2005 to 2006 supports the seriousness of these official statements.

¶16. (SBU) Saddam appears to have created the PDS by executive decree in the early 90s. (Note: Attempts to track down relevant authorizing documents at the MoT have been unsuccessful because such documents, according to the MoT, were destroyed during the war. End note.) As a result, it may be possible for the GOI to reform and eliminate the PDS through Executive branch actions, such as Council of

Ministers directives.

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Educating the Iraqi Public

¶17. (U) As the GOI reforms and eventually eliminates the multi-billion dollar PDS subsidy, Embassy will encourage the GOI to link the recently implemented Social Safety Net to PDS reform in the public mind (ref A). This new Safety Net (ref D) is intended to protect the poorest Iraqis as economic reforms are implemented, and according to Iraqi public affairs officials, Iraqis will not be supportive of subsidy reductions unless they believe the Safety Net works. We will also encourage the GOI to educate average Iraqis on how corruption and inefficiency have plagued the PDS system, outweighing any benefits.

¶18. (SBU) Embassy Econ and MoF co-chair the Economic Reform Public Education Working Group, which also includes Embassy Public Affairs, Treasury, USAID, DFID, the Iraqi Government Communications Directorate (GCD), and representatives from most Iraqi ministries. PDS reform public-education messages could be effectively coordinated through this working group, which is currently developing public messages and delivery strategies to support fuel-subsidy reductions and anti-corruption efforts.

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Comment: Stopping the Cultural Damage for Good
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¶19. (U) Two of the main impediments to Iraq's development of a healthy market-driven economy are massive government subsidies and endemic government corruption. The PDS contributes significantly to both of these. Most critically, however, there is no objective measure for how damaging the current PDS is (and has been) to Iraq's development into a free and democratic society. As long as the GOI continues to pour billions of dollars into the PDS, average Iraqis will be faced with a corrupt government bureaucracy that saps personal initiative without supplying any real benefit to the population. To achieve the transparency and citizen self-reliance necessary for successful democratic government, the GOI should eliminate the PDS and continue to strengthen the new Social Safety Net that supports Iraq's truly needy. The GOI's recent actions and statements demonstrate increased GOI commitment to this line of thinking.

¶20. (U) Our uncertainty about the permanency of this line of Iraqi thinking matches that of DPM Chalabi, Finance Minister Allawi, and other current Iraqi leaders. We will do everything in our power to encourage the new Iraqi government to continue the PDS reform policies of its predecessor, following the established principles of cutting "nonessential" items, providing freedom of choice through monetization, encouraging private-sector growth, gradually eliminating the PDS, and educating the Iraqi citizenry.
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